

Central Intelligence Agency



Washington, D. C. 20505

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Annotated

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DIRECTORATE OF INTELLIGENCE

29 April 1985

Japan: Weighing Near-Term Trade Policy Options

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Summary

Japanese officials are concerned that the 9 April trade package by itself will not stabilize Japan's surplus in the near term. They are therefore assessing new initiatives that might defuse trade friction long enough to allow recent measures--and those to be unveiled in July--time to bear fruit.

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If, however, April trade figures indicate that Japan's surplus is beginning to decline or stabilize, we believe Tokyo will not take any new steps. US Congressional actions on bilateral trade issues, discussion of Japan's surplus at the Bonn Economic Summit, and a power struggle within the Liberal Democratic Party (LDP) also will be key factors in Tokyo's final decision on implementation of bold new trade measures during early summer.

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This memorandum was prepared by [redacted] Japan Branch, Northeast Asia Division, Office of East Asian Analysis. Information available as of 29 April 1985 was used in its preparation. Comments and questions are welcome and may be directed to the Chief, Japan Branch, Northeast Asia Division, OEA, [redacted]

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Consensus Building for Drastic Trade Action

US Senate passage in late March of a resolution calling for retaliation against Japanese goods appears to have broadened support among senior Japanese officials for a dramatic trade initiative. Before the Senate action, only a few high-level officials had called for bold steps such as elimination of all tariffs on industrial goods or a tax on exports. After the resolution passed, other key players in the trade policy arena reevaluated the likelihood of US retaliation and the need for unilateral action by Japan. [REDACTED]

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The consensus for action apparently was not strong enough to permit inclusion of significant measures in the 9 April trade package, but Nakasone left the door open for more dramatic steps. [REDACTED]

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[REDACTED] we believe Nakasone's personal TV appearance introducing the package and stressing the seriousness of trade friction reinforced the existing public support for positive action. [REDACTED]

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With backing for dramatic measures to contain the surplus now beginning to jell, various ministries and LDP leaders are staking out positions on several basic options (see table):

- Import promotion, either through administrative guidance to exporters or through fiscal stimulus to pump up domestic demand.
- Export restraint, either through a tax on exports or by imposing new quotas on foreign sales of selected goods.
- Controls on capital outflow or imposition of an interest equalization tax to negate the difference between Japanese and US interest rates and, thereby, help strengthen the yen and spur adjustment of trade flows. [REDACTED]

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The fiscal stimulus option has received the most press play, especially after Secretary Shultz's request that Japan better utilize domestically the country's abundant savings. [REDACTED] export quotas on such items as autos, electronics, and telecommunications equipment appeal most to Nakasone, apparently because of their assumed effectiveness. [REDACTED]

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JAPAN: TRADE POLICY OPTIONS

<u>Option</u>	<u>Proponents</u>	<u>Opponents</u>	<u>Comments</u>
1. Fiscal stimulus	-LDP faction leader Komoto -LDP Vice President Nikaïdo	-Foreign Minister Abe -Keidanren President Inayama -Ministry of Finance -Prime Minister Nakasone (at least before yearend) -Economic Planning Agency	Unlikely on grand scale. Politically attractive to many LDP politicians, but could undermine Nakasone's efforts to end deficit financing by 1990. In addition, many, including Nakasone and Economic Planning Agency (EPA) economists, doubt effectiveness as import stimulus.
2. Capital controls	-Keidanren President Inayama	-Ministry of Finance	Unlikely to be implemented. Prime Minister Nakasone once advocated this option as means of strengthening yen, but [redacted] it would be viewed internationally as retreat from financial liberalization and would, moreover, be difficult to enforce given liberalization already undertaken.
3. Export surcharge	-Some Finance officials -Some EPA officials	-MITI and Agriculture officials	Unlikely except to preempt US import surcharge. If applied across board, would hurt exporters in depressed as well as vibrant sectors and thus would be politically unpopular.
4. Export restraints on selected goods	-Prime Minister Nakasone -Keidanren President Inayama		Implementation possible in near term. Viewed as attacking what Finance and other bureaucrats in Tokyo see as real heart of trade friction--concentrated exports in sectors such as electronics. Industry may tolerate if considered only real alternative to being cut off from US market. Logistics of implementation and adverse reaction from US importers of targeted products, however, may yet make this option unpalatable.
5. Force top exporters to boost imports, so-called compensatory imports	-Prime Minister Nakasone -Some MITI officials		Implementation started but details unclear. [redacted] this is not the first-choice option of MITI officials, we presume because efficacy of administrative guidance doubtful when dealing with large, independent companies.

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Deciding Whether to Go For Broke

[redacted] the Prime Minister is reluctant to implement measures such as new, or more stringent, voluntary export restraints if the bilateral trade surplus with the United States shows signs of declining naturally. April trade data, which will not be released until mid-May, will be crucial to his assessment of the situation. If the surplus for April is below its year-earlier level--that is, a repeat of the March performance (see chart)--export restraints or other bold trade steps are unlikely. [redacted]

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Nakasone probably would approach Washington to assess the US reaction to export controls before making a decision. Tokyo would not want to repeat the mistake it made on the auto export quota issue. After expending political capital domestically by continuing restraints as a gesture to Washington, Japanese officials discovered that their move only exacerbated Congressional discontent. [redacted]

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We believe Tokyo will take other domestic and international factors into account as well in making a final decision on whether to take drastic measures or instead to concentrate on making progress in sectoral talks and on finishing up the medium-term action plan for liberalizing imports.

- In our view, a decline in rhetoric directed at Japan in Congress would cause Tokyo to have second thoughts about new steps.
- Indications that US importers of Japanese intermediate products, such as semiconductors, would vocally oppose export restraints would also militate against action.
- On the other hand, if Japanese trading practices are singled out for criticism at the Bonn Summit, Tokyo will probably be inclined to move quickly to try to contain the surplus. [redacted]

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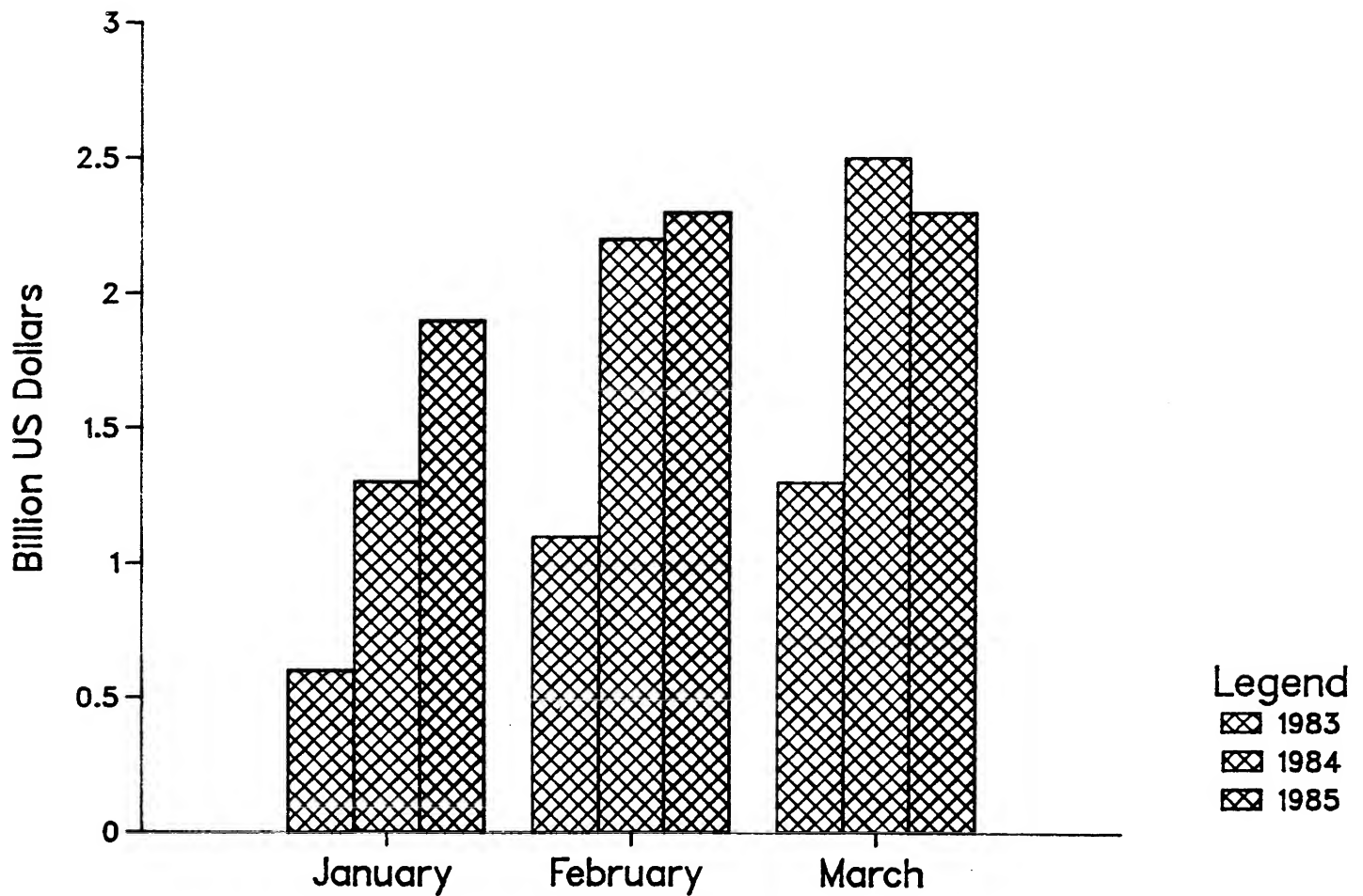
Domestic Political Pressures

Maneuvering by Nakasone's political rivals--eager to succeed him in 1986--will probably influence near-term decisions. Political crosscurrents in the LDP and the desire of key politicians for increased pork barrel funding appear to be factors in the positions adopted by influential leaders on the use of fiscal stimulus to ease trade friction. With pump priming being used as one focal point of internal political maneuvering, Nakasone may have to rethink his trade policy options. [redacted]

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Japan: Trade Balance with the United States



- [REDACTED]
- LDP Vice President Nikaido, a leader of the mammoth Tanaka faction, has called for increased domestic growth as the best means to promote imports and ease tensions despite the fact little public support exists for a retreat from austere administrative reform policies.
 - Finance Minister Takeshita, another leader of the Tanaka faction, supports Nakasone's austere budget policies. We believe Nikaido's and Takeshita's skirmish over budget policies may be tied to their battle for future control of the faction and the right to succeed Nakasone as Prime Minister.
 - The smaller Suzuki and Komoto factions agree with Nikaido on the need for stimulus. Their support for such action stems in part, we believe, from a desire to undermine Nakasone's authority. Former Prime Minister Suzuki has been openly critical of Nakasone's failure to consult the LDP before entering into sectoral trade talks with the United States on politically sensitive issues such as forest products. [REDACTED]

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